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SUBJECT: PENSION REFORM: THINK BIG, SETTLE SMALL; GOVERNMENT  
FINALIZES MODEST REFORM PACKAGE

REF: a) ROME 2474 b) Rome 1899

1. (SBU) Summary: The Berlusconi government has hammered out a pension reform package after two years of speculation, coalition wrangling and increasingly dire warnings over the system's unsustainability. Prime Minister Berlusconi was forced to settle for a modest package that falls short of the ambitious overhaul sought by Finance Minister Tremonti and a host of economists, businessmen and Eurocrats. Now he faces a tough fight to overcome organized labor's opposition and win public acceptance for even this modest proposal. Italy's potent trade union confederations are gearing up for an autumn of strikes and agitation to; their ire stems more from the government's tactical decision to freeze them out of the bargaining than from the meat of the package. The furor over pension reform won't topple this Berlusconi government as it did his first regime in 1994, but it will ensure a bumpy ride the rest of this year. End Summary.

2. (U) In a highly unusual direct appeal, Prime Minister Berlusconi addressed the Italian nation September 29 to pitch the pension reform package approved by the Council of Ministers earlier that day. His remarks, carried by the national public TV networks, emphasized the unsustainability of Italy's current public pension system and his government's determination to reform it. The reforms would be just and wise, in that they would be introduced gradually and would not change requirements for those workers poised to retire. The prime minister's address capped a months-long series of often bruising negotiations among the coalition members over the terms of the reform package. Negotiated concurrently with the annual budget package, the pension reform plan will be amended to a proposal already passed by the Chamber of Deputies (ref a) that would redirect severance pay that companies currently hold in escrow to private pension funds and would reduce employers' required contributions to the public pension system for young workers.

3. (U) The pension reform package contains a mix of immediate and longer-term fixes. In the short term, the package will:

- waive payroll taxes for retirement-eligible workers who decide to stay on the job past their initial retirement eligibility date, increasing their take-home pay by as much as 35 percent;

- increase payroll tax rates for self-employed and independent workers, to provide some additional short-term inflow and pare the pension system's near-term operating deficit;

- impose a surcharge on a group of wealthy pensioners who, although entitled to a public pension, don't need one to maintain a decent standard of living.

The heart of the reform proposal would not be implemented for an additional five years. Beginning in 2008, prospective pensioners will face tougher eligibility requirements for public "seniority" (defined benefit) pensions. To qualify at that point, pensioners will have to:

- have worked, and contributed to the pension system, 40 years (vice the current 35); or

- be at least 65 years old (men) or 60 years old (women), vice the current threshold of 57.

According to Tremonti, the tougher qualifying requirements should generate roughly 12 billion Euro in savings over the remaining 30 years of the defined-benefit "seniority" pensions, which will gradually phase out as workers shift to defined-contribution schemes under the terms of the 1995 Dini reform package.

4. (SBU) Although Tremonti (supported by Central Bank Governor Fazio, EU Commissioner Solbes and others) had

sought more radical reforms that would have introduced penalties for early retirement and phased in the tougher eligibility requirements more quickly, the center-right coalition's conflicting interests gradually whittled the

package down. The Northern League refused to countenance early retirement disincentives or rapid phase-in of tougher eligibility requirements, reflecting one of its core constituencies, northern workers. National Alliance resisted attempts to pare the pension benefits enjoyed by public sector workers, although the public employees' unions are furious that the incentive program will be limited to private sector workers. Finally, the Union of Christian Democrats of the Center resisted cuts to Italy's generous disability benefit scheme. In the end, the modest package was the best Berlusconi could realize.

15. (U) Meanwhile, organized labor watched -- and steamed -- from the cheap seats. Accustomed to a collaborative process in which their views were solicited as prior coalitions crafted proposals and draft budgets, the major trade union confederations grew increasingly angry as the center-right government repeatedly postponed discussions while it haggled over the details of the package. The unions believe that structural pension reform isn't really necessary, but to varying degrees were prepared to support some elements of a reform package, such as incentives to postpone retirement. Berlusconi and his coalition partners presented their finished proposal to the confederation leaders September 29 and said they were prepared to discuss adjustments consistent with the package's objectives -- but it would have to be done in three days, in order to maintain the timetable for presentation to Parliament. Not surprisingly, the unions rejected these conditions; when Berlusconi elected to pitch the package on national television, they immediately announced a four-hour general strike October 24 and warned of additional labor actions and unrest if the reform package went forward unaltered.

16. (U) Employers' associations joined Tremonti in advocating a more radical, effective reform package, but they appear inclined to accept the more modest reform in exchange for reduction of some payroll taxes and other financial incentives for companies.

17. (SBU) COMMENT: The Berlusconi government's reform package is a further step in the right direction, but it will not generate the budgetary savings and alter the government's balance sheet enough to cut the deficit, foster economic growth or promote job creation in the short term. Deferring the major reform elements until 2008 also defers needed deficit reduction, and the near-term incentives ironically may increase pension spending over the next five years. That said, it's the best package this coalition could produce. The fight over pension reform exposes the most basic of the many differences among the coalition members that impede Berlusconi from pursuing the bolder economic and political reforms that he promised would make his government different from its predecessors.

18. (SBU) Berlusconi's more confrontational line with organized labor is, at this stage, more positioning than principle. The government's had some past success in reaching accords with the two more moderate confederations (CISL and UIL). There are indications that discussions continue behind the public posturing, with the confederations seeking a more gradual introduction of the tougher eligibility requirements. A government agreement with the two moderate unions (CISL and UIL) would cement a majority of public opinion behind the reform proposal. It would also eliminate another issue around which the three increasingly fractious trade union confederations might coalesce. But the price would be further softening of an already modest package. End Comment.

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